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ISSUES IN DESIGNING A PRESCRIPTION DRUG BENEFIT FOR MEDICARE

Medicare offers broad insurance protection for many health needs of the nation's elderly, but it provides very limited coverage for the costs of prescription drugs not dispensed during a hospital stay. That gap in coverage has become increasingly significant as prescription drugs have become more important in the treatment of disease and as spending for them has soared.

Despite Medicare's limited drug coverage, most beneficiaries have not faced the full effects of the rapid rise in drug spending. The reason is that roughly three-quarters of the Medicare population has insurance coverage for outpatient prescription drugs through such sources as employment-based plans for retirees, private medigap plans, or Medicaid. Even the one-quarter of Medicare beneficiaries who lack drug coverage use a significant quantity of prescription drugs. Thus, a fundamental effect of a Medicare drug benefit would not be to provide for the use of prescription drugs but rather to redistribute the cost of drugs away from current payers to the federal government.

Designing a Medicare drug benefit is a complex task. The competing goals for such a benefit mean that policymakers must make trade-offs (such as between cost and extensive coverage or widespread enrollment). They need to consider many different design elements and how those elements might interact. And they need to avoid various problems that arise in creating a drug benefit—for example, the possibility that the coverage will mainly attract people with the highest drug costs, the ability and willingness of private companies to administer the drug benefit, and the possible impact of the benefit on other parts of Medicare. Moreover, the choices that designers make will affect not only the cost of the Medicare drug benefit but such factors as demand for and prices of prescription drugs, spending by other federal and state programs, and how various parts of the health insurance market operate.

The Congressional Budget Office (CBO) has had to wrestle with those complex issues to produce cost estimates for the various Medicare drug proposals debated in the Congress. This study summarizes the main design choices facing policymakers and explores the implications of those choices for cost and coverage. To illustrate the effect of those choices on cost, it also discusses CBO's cost estimates for four proposals that represent a broad array of designs for a Medicare drug benefit.

The most important feature determining the cost of a Medicare drug benefit is the scope and structure of its coverage and the amount of the benefit that the federal government chooses to subsidize. In addition, CBO has concluded that certain administrative features offer the greatest opportunity to control federal costs and total spending on outpatient prescription drugs. Those features are allowing benefit managers to employ the full array of cost-management tools now available to private-sector drug plans, forcing benefit managers to compete among themselves for enrollees' business, and making managers assume financial risk for delivering benefits.

The four drug proposals examined in this study would cost a total of between $195 billion and $512 billion over their first eight years (assumed to be 2005 to 2012). Those totals reflect the federal costs of the new Medicare benefit, including subsidies for low-income enrollees, partly offset by savings in other federal health care programs.

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